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C O N F I D E N T I A L SECTION 01 OF 04 YEREVAN 000454

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TAGS: [PGOV](#) [PREL](#) [EAID](#) [ECON](#) [EAGR](#) [KDEM](#) [KWMN](#) [AM](#)  
SUBJECT: ASSISTANCE COORDINATOR FINDS MORE ENTHUSIASM FOR  
ECONOMIC THAN POLITICAL REFORMS

REF: A. (A) YEREVAN 411  
[1](#)B. (B) YEREVAN 316

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Classified By: CDA Pennington for reasons 1.4 b and d.

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SUMMARY  
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[1](#)1. (C) GOAM ministers told EUR Assistance Coordinator Tom Adams May 16 of their eagerness for economic reforms to eliminate corruption in the tax and customs areas, increase foreign investment, and reduce economic inequality. On political reforms, the ministers, especially FM Nalbandian, rehashed the same (flawed) GOAM version of post-election events, like President Sargsian the day before (Ref A), and had little constructive to offer. END SUMMARY.

[1](#)2. (C) Assistance Coordinator Tom Adams and his deputy (and soon-to-be successor), Daniel Rosenblum spent May 15-16 in Armenia in bilateral discussions with the Armenian President (Ref A), Prime Minister and Ministers of Foreign Affairs, Finance, Economy and Agriculture, in the context of the semi-annual U.S.-Armenia Task Force on Economic Cooperation (USATF), which Adams co-chairs with the Finance Minister. In addition to following up on issues raised and actions proposed at the October 23, 2007, USATF meeting in Washington, Adams took this opportunity to introduce Rosenblum to his USATF interlocutors and to reinforce messages about democratic reforms and their connection to the future of U.S. assistance, including Armenia's current MCC compact.

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FM: the GOAM is "taking steps" to move forward...  
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[1](#)3. (C) In his meeting with Foreign Minister Eduard Nalbandian, Coordinator Adams discussed the future of the MCC compact in light of Armenia's perceived backsliding on democracy since the February 19 presidential elections and other issues. Nalbandian received Adams and Rosenblum warmly, stating that one of his first acts as FM was to review U.S.-Armenian relations and to seek ways to make them closer and stronger, especially in light of the nearly USD 2 billion the U.S. has given Armenia since independence.

[1](#)4. (C) Nalbandian insisted that President Sargsian was committed to "taking the necessary steps" to relieve the current political tension. He said the GOAM has made the "conscious choice" to adopt democratic reforms, asserting (much as President Sargsian had the day before) that the February elections had been deemed by international observers as an improvement over the previous ones and that the events

of March 1 had been the result of the protesters and the lack of police preparation. He further chided the press for being "irresponsible and printing lies," noting that the GOAM is committed to working on media-related issues regarding freedom of expression. Adams did not mince words when he contradicted Nalbandian, saying that the elections had been marred by significant shortcomings and that the post-election situation was only exacerbated by the continued detention of political prisoners and the ongoing arrests of their sympathizers. Adams explained that the MCC Compact and other assistance such as FREEDOM Support Act (FSA) funds are tied to good governance and reiterated that Washington was seriously considering and -- and in the case of FY07 FSA Performance Funds -- had already decided to withhold valuable assistance money from Armenia.

15. (C) On other issues, Nalbandian said he was eager to see the Ambassador-designate come to Armenia and offered that he would be relating this to the Armenian-American community the next time he is in the U.S. Nalbandian agreed with Adams when the latter noted that the GOAM needs to address corruption better. While Tom Adams mentioned Armenia's continuing Tier Two Watch List (T2WL) status with regard to Trafficking in Persons, Nalbandian did not respond. However, when Adams asked about the GOAM's registration of NDI as an NGO -- an action item that has appeared on the USATF agenda for some time with no action -- Nalbandian said he would personally study the issue and "work on it."

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PM SARGSIAN: FOR REFORMS, AGAINST CORRUPTION  
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16. (C) Adams asked PM Tigran Sargsian about the state of Armenia's economy and prospects for a clampdown on corruption

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within the tax and customs services. Sargsian reported that Armenia's foremost economic problem is the rise in food and fuel prices and the challenge of keeping inflation in check to prevent social unrest. He noted that while macroeconomically, Armenia is the most stable economy in the region, two problems loom large: corruption in the tax and customs services and "de-dollarization." (NOTE: Because of the weakening of the U.S. dollar -- widely used as the currency for the shadow economy -- many individuals over the past year have begun to convert their dollars into Armenian drams, which has strengthened. This, naturally, has put strain on the Central Bank of Armenia, which has had to help boost the dram to prevent it itself from precipitously devaluing. END NOTE.) About the latter, Sargsian blamed the shadow economy for flooding the Armenian market with USD, which "causes havoc" within the Armenian financial sector when it is exposed to the world market. On the former, Sargsian reported that the new GOAM was determined to root out the problems within tax and customs. He said that for one month already, the GOAM has restrained the State Customs Committee (SCC) from taking bribes and that his office is bearing the brunt of SCC pushback. He said the speed of reforms will determine which side will win in this struggle. He announced that he had created two monitoring groups to oversee SCC reforms and to enshrine transparency. Noting that his policies on transparency while at the Central Bank had led to successful reforms in the banking sector, Sargsian stated that he could accomplish the same within the State Tax Service (STS), including disclosing the assets of the largest taxpayers, making radical personnel changes and establishing an electronic system to keep taxpayers from interacting directly with tax collectors (thereby minimizing rent-seeking opportunities). Sargsian noted that these changes could be aided with USG technical and other assistance. He rebutted rumors that the SCC and STS might be merged, while noting the two agencies would have to cooperate.

17. (C) On law enforcement reform, Sargsian volunteered to Adams that March 1 proved that radical reforms are needed

within the security services. He said his vision was to recruit young, dedicated specialists without the taint of corruption to safeguard against conflicts of interest. He said he was conferring with international institutions to identify the weak points within the security services that must be reinforced. In welcoming Sargsian's remarks, Adams pointed to the recent use of the STS for political purposes as a concern for the development of the people's trust in state institutions. He also pressed the PM to prosecute money-laundering offenses, to ensure the independence of the recently completed, USG-funded forensics lab, to support the interconnectivity of police and border guards to improve communication and to remove disincentives to investment by solving the problem of seriously delayed tax refunds to foreign companies. The PM agreed, stating that the Armenian "people are waiting for action, not speeches" and "We will be acting on our declarations." In further stating that his government had come to power to enact radical reforms, he noted that the GOAM has invited the opposition to participate in anti-corruption and other structures in which its voice can be heard. He stated resolutely that GOAM actions against the opposition must be stopped.

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FINMIN: WE ARE TACKLING THE ECONOMIC PROBLEMS  
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¶8. (C) New Minister of Finance and USATF Co-chair Tigran Davtian acknowledged that the GOAM has a considerable amount of work to do in the economic sphere, especially with regard to fighting inflation, clamping down on corruption and promoting exports. Davtian's said his top priority is fighting inflation )- which ran at a 10.7 percent annual rate in the first part of 2008, due largely to rising food and fuel prices and &de-dollarization8 through remittances. Davtian reported that he expects modest appreciation of the Armenian dram to temper some of the impact and that the GOAM will also aim to reduce the budget deficit and increase competition. While asserting that there are no monopolies in Armenia, Davtian admitted that there are a number of firms with sizeable market shares (over 25 percent) that easily collude on prices. The only true monopoly in Armenia, he said, was telecommunications, which, he reported, has now been opened to competition.

¶9. (C) Like the PM before him, Davtian pointed to the elimination of corruption in both the STS and the SCC as high GOAM priorities because they both pose inflationary risks. (NOTE: Neither institution falls under Davtian's supervision

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as Finance Minister. END NOTE.) He said there is strong will in the GOAM to reform both agencies despite the fact that wider compliance with the law will increase costs of doing business, with firms no longer able to pass on some of their "savings" from noncompliance to their customers. (NOTE: In late April, President Sargsian very publicly fired the Director of the SCC as part of an apparent crackdown on the notoriously corrupt agency; we now hear that SCC staff are not accepting bribes and are doing business "by the book," which has increased costs for many businesses and slowed processing times. Some staff, no longer able to supplement their modest wages with bribes, are said to be considering resigning. END NOTE).

¶10. (C) Davtian said that by 2009 he hoped to introduce a new electronic system to manage such activities as procurement, treasury and internal audit, and consequently reduce corruption opportunities for government officials. Davtian indicated he will need a more skilled professional staff, and this will require a substantial increase in salaries (which now range from about USD 300/month for mid-level staff to USD 600/month for a minister).

¶11. (C) Davtian acknowledged that Armenia is not an attractive market for investors, given its small size and the

closed borders with Turkey and Azerbaijan. While he agreed with Adams that opening the border with Turkey would improve the economic situation, Davtian asserted that even improved ties to Georgia would be a good start and that the GOAM is ready to increase economic cooperation with Georgia; he sees little likelihood that relations with Turkey and Azerbaijan will improve in the near term. He said, "Armenia needs to create a better business climate than its regional neighbors in order to overcome some of its comparative disadvantages." With regard to VAT refunds, which the GOAM has been very slow to pay in recent years and which has become a sore point for U.S.-based exporters, Davtian mentioned that the GOAM has allocated AMD 22 billion (about USD 72 million) for such refunds in FY 2008, and that making these rebates is a high priority for the GOAM, given its desire to encourage the export sector. (NOTE: None of these funds has yet been disbursed, and the budgeted amount reportedly falls well short of what is owed to businesses. END NOTE.)

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ECONMIN: WE ARE AIMING FOR FOREIGN INVESTMENT  
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¶12. (C) Meeting with Tom Adams for the first time as Minister of Economy -- a hybrid of part of the old Ministry of Finance and Economy and the former Ministry of Trade and Development -- Nerses Yeritsian provided Adams with an overview of the GOAM's economic development plan, with its theme of "Armenia as a Center for Excellence." He emphasized the need to develop a knowledge-based rather than factor-driven economy, and to build a sophisticated, high-quality infrastructure for a knowledge economy. He placed particular importance on assisting development of the information technology industry through such projects as the Gyumri Technopark and stronger intellectual property rights (IPR) protection, necessary in light of Armenia's world-leading 93 percent piracy rate, and also critical to Armenia's economic self-interest.

¶13. (C) Yeritsian explained his drive to make Diasporan Armenians "entrepreneurs, not a wallet," by stating that Diasporan investors speak the language and know the country better than others, and should be in a good position to bring in high standards of quality and transparency. Adams countered by mentioning that many Diaspora investors with whom he has met have refused to invest in Armenia because of its high levels of corruption. Yeritsian said his plans include placing a Diasporan on the GOAM's Competitiveness Board who could contribute needed expertise and would not be afraid to say "no" to corruption.

¶14. (C) Among impediments to economic progress, he mentioned the poor quality of public administration, corrupt tax and customs regimes, the lack of capacity to do economic analysis and benchmarking, and limited language competence; he suggested that all Civil Service employees should be competent in English as a second language. He noted that the GOAM will soon begin negotiating a free trade deal with the European Union, which would force the SCC to comply with EU standards. He also called for a shift of mindset in the public's attitude that government must be the provider of all their needs. Yeritsian, who has been designated the GOAM's point of contact on the Millenium Challenge Corporation (MCC) indicators remediation, stressed that even if the project is

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suspended or cancelled, the framework of that initiative, with its transparency and zero tolerance for corruption, will continue to have a positive impact on Armenia's economic development.

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AGMIN: WE'VE GOT MORE WORK TO DO AND COULD USE HELP  
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¶15. (C) In his meeting with Agriculture Minister David Lokian, Adams praised the work Lokian had been doing with regard to the establishment of farm credit institutions and

raised several issues that had remained unanswered following the last USATF meeting. Foremost was the animal health situation, which has been deteriorating in Armenia (septel). When Adams asked about the status of the airport's recertification for handling biohazardous materials, Lokian reported that work was being done on the documentation and the preparation of allocated space for these materials at the airport and predicted the entire recertification process would be completed by August.

¶16. (C) A constant theme in the meeting was the GOAM need for further technical assistance and training to combat the animal diseases that currently plague Armenia, including the establishment of a rapid response team to the stockpiling of reagents, disinfectants and the like. With regard to the GOAM plan to plant and harvest massive amounts of corn and wheat to safeguard food security (Ref B), Adams offered to send an assessment team to Armenia to review the situation and offer its advice with regard to the plan.

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COMMENT  
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¶17. (C) While we welcomed the GOAM's strong, positive messages with regard to tackling corruption and increasing transparency on the economic front, Armenian interlocutors -- with the partial exception of the Prime Minister -- seemed in deep denial about the political crisis, and unwilling to concede any government fault. This was a very discouraging round of meetings for our hopes for the new Armenian administration to get back on a democratic track. Post greatly appreciated, however, Adams' clarity in conveying the tough messages to GOAM partners that Washington takes the democracy and human rights deficiencies seriously, and serious consequences are on the way -- for MCC and U.S. engagement generally -- if Armenia does not get serious about remediating these problems. END COMMENT.

¶18. (U) EUR/ACE Assistance Coordinator Tom Adams cleared on this cable.  
PHILLIPS